SECTOR UPDATE

Banking – Malaysia

Prime Beneficiary Of A Soft Landing

Despite an uncertain macro backdrop from US tariffs, we upgrade the sector to OVERWEIGHT after its ytd underperformance. Resilient earnings, attractive dividends, and its position as a prime beneficiary of EM rotation from Fed easing are, in our view, key catalysts. The sector offers defensive shelter while retaining upside potential in the early phase of a cyclical recovery. We also take the opportunity to upgrade CIMB to a BUY and our sector recommendation to OVERWEIGHT.

WHAT'S NEW

- **US inflation numbers softer than expected despite tariffs.** The July 25 US CPI report remained relatively contained despite tariff effects, with core CPI at 3.1%, only slightly above 2.8% in April, and headline CPI at 2.7%, just below the 2.8% forecast. However, much of the tariff impact may still be muted as businesses draw on front-loaded inventories purchased at lower tariff rates. With goods CPI comprising only 25% of both core CPI and PCE – while services account for the remaining 75% – the inflationary impact from tariffs may prove more manageable than initially feared. Additionally, corporates may choose to absorb part of the tariff impact while passing it to consumers gradually to help soften the impact. Productivity gains from technology adoption and selective tariff exemptions allows corporates to preserve overall margins.

- **Rising rate cuts odds-paving the way for potential soft landing?** At the same time, the US labour market has shown signs of cooling, with May–June non-farm payroll gains coming in 235,000 below forecasts. A sustained slowdown in hiring could eventually feed into weaker wage growth and, in turn, softer services inflation – the component that accounts for 75% of CPI and PCE. Reflecting these dynamics, market expectations for monetary easing have strengthened, with futures now pricing a 92% (as high as 96% before July PPI data) probability of at least one rate cut in September and a 60% chance of a second cut before year-end 2025.

- **Malaysian banks to benefit from emerging market inflows.** The narrowing of the Fed Funds Rate–Overnight Policy Rate spread, alongside resilient macro growth supported by softer-than-expected tariff-driven inflation, could spur emerging market inflows. Malaysian banks, with strong liquidity, resilient earnings, solid provision buffers, and around 5% dividend yields, are well placed to benefit, especially after underperforming the KLCI ytd. While foreign shareholding in the sector continued to fall in 2Q25, the decline slowed significantly to 0.2ppts from 1.5ppts in 1Q25. This may suggest that value is emerging in the sector, despite lingering concerns over how the US tariffs could weigh on the macro outlook and, in turn, impact banks.

ACTION

- **Upgrade to OVERWEIGHT.** Despite tariff-driven macro uncertainties, we turn bullish on the sector, seeing it as a key beneficiary of a potential EM rotation. A soft US landing could allow the Fed to cut rates while sustaining growth and with markets likely having priced in all the potential OPR cuts in 2H25, setting the stage for a NIM recovery in 2026 and consequently for the sector to outperform. We roll forward valuations for December FYE banks to 2026 (with non-December FYE banks already on FY26 valuations peg), as we expect the market to look beyond 2025 OPR cuts toward NIM recovery in 2026 as an increasingly risk on sentiment gains traction.

OVERWEIGHT

(Upgraded)

TOP SECTOR PICKS

Company	Rec	Share Price (RM)	Target Price (RM)
Public Bank	BUY	4.45	5.24
CIMB	BUY	7.25	8.25
HL Bank	BUY	19.62	23.80
RHB	BUY	6.43	7.55
AMMB	BUY	5.51	6.08

Source: UOB Kay Hian

BANKS' SHARE PRICE PERFORMANCE

Company	Price (RM)	yoy % chg	ytd % chg
AMMB	5.51	18.0	0.6
RHB Bank	6.43	12.0	(0.3)
Public Bank	4.45	3.7	(2.0)
Maybank	9.80	(4.5)	(3.7)
Alliance Bank	4.58	12.8	(3.8)
HL Bank	19.62	0.3	(3.9)
Bank Islam	2.30	(13.2)	(7.6)
HLFG	16.74	(2.9)	(7.7)
CIMB Group	7.25	(5.4)	(10.8)
Affin Bank	2.40	(19.7)	(13.4)

Source: Bloomberg

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PEER COMPARISON

Company	Ticker	Rec	Share Price (RM)	Target Price (RM)	Market Cap (US$m)	PE (x) 2024	PE (x) 2025F	PE (x) 2026F	ROE 2025F (%)	P/B 2025F (x)	Div 2025F (sen)	Div Yield (%)
Public Bank	PBK MK	BUY	4.45	5.24	19,640	12.1	11.7	11.0	12.5	1.5	22.9	5.1
CIMB Group	CIMB MK	BUY	7.25	8.25	16,616	10.1	10.0	9.2	10.9	1.1	39.3	5.4
HL Bank	HLBK MK	BUY	19.62	23.80	9,867	10.0	8.3	8.3	12.2	1.0	94.2	4.8
RHB Bank	RHBBANK MK	BUY	6.43	7.55	6,378	9.0	8.8	8.3	9.5	0.8	47.7	7.4
HLFG	HLFG MK	BUY	16.74	21.40	4,359	6.3	5.5	5.1	10.6	0.6	53.1	3.2
AMMB	AMM MK	BUY	5.51	6.08	3,979	8.3	9.0	8.5	9.4	0.8	37.0	6.7
Maybank	MAY MK	HOLD	9.80	10.52	26,926	10.9	10.7	10.5	10.6	1.1	68.4	7.0
Alliance Bank	ABMB MK	HOLD	4.58	4.84	1,844	9.5	8.9	8.4	9.8	0.9	23.1	5.0
Affin Bank	ABANK MK	HOLD	2.40	2.55	1,434	11.4	11.0	9.0	4.5	0.5	6.6	2.7
Bank Islam	BIMB MK	HOLD	2.30	2.45	1,203	8.4	8.6	8.1	7.0	0.6	13.4	5.8

Source: UOB Kay Hian

- **Upgrade CIMB to BUY.** Despite the recent share price recovery, the stock remains a sector laggard, down 10% ytd vs the KLFIN Index's 3% decline. This has compressed valuations to an appealing 1.0x 2026 PBV, below the sector average of 1.1x despite a generating higher ROE of 11% vs sector's 10%. The ytd sell-down partially stemmed from tighter liquidity in Indonesia pressuring CIMB Niaga's NIMs, but conditions began easing in Jun 25, with the resumption of Fed rate cuts set to further improve liquidity. Potential earnings catalysts include improving liquidity conditions in Indonesia to drive a recovery in NIM and stronger-than-expected non-interest income from trading gains.

- **Top sector picks**. Our BUY list blends high-beta names with attractively valued banks. Reflecting a stronger risk-on stance, we have included three high-beta picks – CIMB, RHB, and AMMB – while maintaining conviction in Public Bank and Hong Leong Bank, which continue to trade at -1SD below historical mean PBV and offer solid provision buffers.

ESSENTIALS

- **Foreign bond flows could spill over into equities.** Foreigners have been net buyers of domestic government bonds, driving the 10-year MGS yield down to 3.37% from 3.68% at the start of the year – below the pre-pandemic average of 3.7% despite the OPR remaining at similar levels. We believe this trend could eventually spill over into Malaysian banks once macro uncertainty subsides. The banking sector's earnings yield spread to the 10-year MGS stands at 7ppts, significantly wider than the broader KLCI-MGS spread of around 4ppts, reinforcing its appeal as a sector rotation play.

- **Manageable NIM hit from OPR cuts – 2025 likely cyclical bottom?** We factor in an additional potential 25bp OPR cut in 2H25 to 2.50%, with only a modest 2bp NIM impact (~2% of sector earnings) after taking into account the mitigating effect of the 1ppt statutory reserve requirement (SRR) cut. Excluding the COVID-19 period, past OPR moves have been limited to an average of 25bp, keeping rates largely within the 2.75-3.25% range. Hence, a cut to 2.50% in 2025 could mark the end of the current rate cut cycle, given GDP growth is still projected at a healthy 4.0-4.8% range by BNM (UOBKH forecast: 4.0%) and inflation remains benign (1.75%-2.35%).

- **Front loading OPR cuts could jump start NIM recovery in 2026.** More importantly, if BNM pre-emptively mitigates downside risks to the economy by front-loading a second OPR cut in 2025, it could pave the way for a NIM recovery in 2026, as deposits begin repricing lower by 1Q26, assuming a final 25bp cut in Nov 25. As such, we believe a potential 25bp cut in either September or November would be seen positively, removing an overhang and prompting the market to price in a sequential NIM recovery from 1Q26 onwards, as fixed deposits are repriced lower.

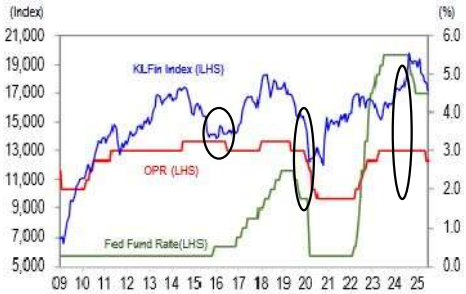
- **Asset quality continues to benefit from structural de-risking of portfolio.** Sector GIL ratio improved to 1.42% in Jun 25, near historical lows, versus the pre-COVID average of 1.5%–1.7%. This reflects stronger underwriting standards, pr-active recovery efforts and structural de-risking, with mortgages – which are considered safer assets – rising from 30% to 36% of banks' loan portfolios.

- **Higher provisions buffer to help stabilise credit cost trend.** Stronger asset quality loans mix and higher LLC ratios (90% vs pre-pandemic 80%), alongside GILs near historical lows, support stable credit costs despite tariff headwinds. We keep sector net credit cost assumptions flattish at 18bps in 2025 (vs 17bps in 2024), implying that minimal write-backs have been factored into our assumptions as we take a more cautious stance. Public Bank, however, offers greater write-back potential given its robust LLC.

- **Non-interest income tailwinds.** We see non-interest income upside surprise from stronger trading gains as 10Y MGS yields fell to 3.37% (14 Aug 25) from 3.68% ytd on robust foreign inflows, potentially boosting banks' FVOCI reserves by 20–30% to a 5-year high. Further US dollar weakness should support forex hedging fees, while a risk-on environment points to wealth management income recovery in 2026.

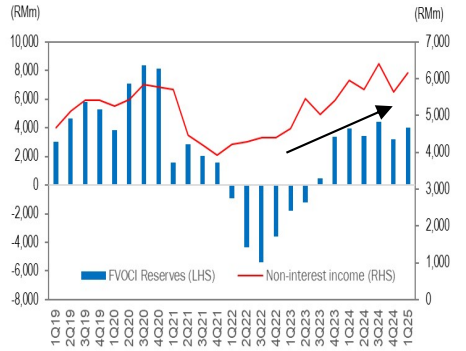
- **Stable and steady earnings growth outlook.** We expect sector earnings to grow 4%/6% in 2025/26, with a stronger rebound in 2026 as deposits reprice lower, lifting NIM. Resilience is underpinned by a loan growth of around 5%, stable credit costs, manageable NIM pressure, and potential non-interest income upside. While sector earnings track the FBMKLCI, steady visibility and attractive yields make banks a defensive safe harbour, with scope to outperform in the early stages of a cyclical recovery.

KLFIN FINDS IT BOTTOM AT EARLY STAGES OF OPR CUT CYCLE



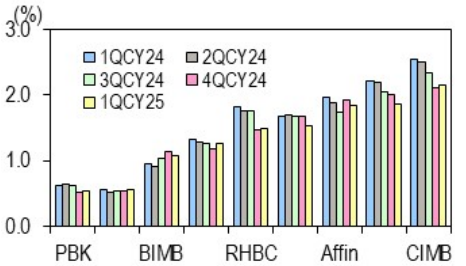
Source: Bloomberg

BANKS AGGREGATE NON-INTEREST INCOME VS FVOCI RESERVES



Source: UOB Kay Hian, Companies

BANKS QUARTERLY GIL RATIO TREND



Source: UOB Kay Hian, Companies

SECTOR PBV

Source: UOB Kay Hian, Companies

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